No. 14,792

In the United States Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JACOB (JAY) PALEY and LILLIAN PALEY, RESPONDENTS

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE PETITIONER

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CITATIONS

Statute—Continued

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OPINION BELOW

The opinion of the Tax Court (R. 23-25) is reported at 22 T.C. 1236.

JURISDICTION

This petition for review (R. 26-27) involves federal income taxes for the taxable years 1948 and 1949. On March 20, 1952, the Commissioner of Internal Revenue mailed to the taxpayers notice of deficiencies in the total amount of $36,249.09. (R. 10-17.) Within ninety days thereafter and on May 13, 1952, the taxpayers filed a petition with the Tax Court for a redetermination of the deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 3, 5-9.)

The decision of the Tax Court was entered on January 10, 1955. (R. 25.) The case is brought to this Court by a petition for review filed on April 1, 1955. (R. 26-27.) Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Under Section 117 (j) of the Internal Revenue Code of 1939, a net gain from the sale of depreciable business assets is entitled to capital gain treatment, but a net loss from such sale is deductible in full as an ordinary loss. Where a taxpayer sustains individual losses of this nature, but in the same year is a member of a partnership which realizes net gains of the same nature, must he offset his distributive share of the partnership gains against his individual losses in computing the net figure contemplated by Section 117 (j)?

STATUTE INVOLVED

The pertinent provisions of the statute involved are set forth in the Appendix, *infra.*

STATEMENT

A stipulation of the parties (R. 19-22) was adopted by the Tax Court as its findings of fact (R. 23). As revealed by the stipulation and the exhibits thereto (which consist of the pertinent individual and partnership tax returns) the facts material to this appeal may be summarized as follows:

Taxpayers were husband and wife. They filed joint returns for the years 1948 and 1949. (R. 19; Stip. Exs. 1-A, 2-B.) During the same period the husband was associated with Joseph M. Schenck in a partnership (referred to herein as Arrowhead) which filed

partnership returns for the fiscal years ended October 31, 1948 and 1949. The husband held a 50 percent interest in the profits of the partnership. (R. 19-20; Stip. Exs. 3-C, 4-D.)

In 1948 taxpayers sustained a casualty fire loss. It is stipulated that this loss was of the type described under Section 117 (j); and that the correct amount of the loss was $44,420.12. In 1949 the taxpayers sustained an individual proprietorship net loss in the amount $106,214.98. It is stipulated that this loss, also, was of the type described under Section 117 (j). (R. 20-21.)

The Arrowhead partnership sold the Arrowhead Springs Hotel prior to the tax years in question; and realized gains therefrom in 1948 and 1949. It is stipulated that these gains were of the type described under Section 117 (j) of the Internal Revenue Code of 1939. It is further stipulated that the taxpayer-husband's share of these gains for 1948 was $37,675.62, and his share for 1949 was $28,333.28. (R. 20-22.)

In their joint returns for 1948 and 1949, taxpayers deducted in full their individual Section 117 (j) losses, in computing their net income. As for the taxpayer-husband's shares of the Arrowhead partnership's Section 117 (j) gains, the taxpayers took 50 percent of these into account as long-term capital gain. (R. 20-22.)

Upon auditing taxpayers' returns for 1948 and 1949, the Commissioner determined deficiencies upon the ground *inter alia* that the taxpayer-husband's shares of the Arrowhead partnership Section 117 (j) gains for 1948 and 1949 should have been taken into account 100 percent, together with taxpayers' individual Sec-

tion 117 (j) losses, in computing a single Section 117 (j) net figure. (R. 21-22.)

The Tax Court ruled, however, that taxpayers' manner of reporting separately their individual and partnership Section 117 (j) items was correct. (R. 23-25.)

STATEMENT OF POINT TO BE URGED

Computation of a taxpayer's net gain or loss under Section 117 (j) of the Internal Revenue Code of 1939 must include the taxpayer's share of partnership gains or losses under Section 117 (j), and the Tax Court erred in ruling to the contrary.

SUMMARY OF ARGUMENT

Under Section 117 (j) of the Internal Revenue Code of 1939, a net gain from the sale of certain non-capital assets is entitled to capital gain treatment, but a net loss from such sale is deductible in full as an ordinary loss. In the case at bar the question of law presented is whether computation of a taxpayer's net gain or loss under Section 117 (j) must include his share of such partnership gains or losses. The Tax Court answered this question in the negative. The Commissioner contends that the Tax Court erred and that its decision must be reversed.

The partnership provisions of the 1939 Code reveal that a partnership has no independent status taxwise save for limited accounting purposes. The individual partners are the taxpayers; collectively, they realize the partnership gains and sustain the partnership losses. It follows that partnership items retain their identity in the hands of the partners, despite the computations of partnership income required by the statute.

This is particularly true where Congress has ex-

pressly required that a taxpayer take into account all of his gains and losses of a given nature in reaching a net figure. Section 117 (j), which so provides, is a relief measure focussed upon the individual taxpayer. The net figure thereunder is ambivalent; if a gain, it is capital, if a loss, it is ordinary. Insulation of partnership gains and losses under Section 117 (j) from those of the individual partners would allow a taxpayer to have both a capital gain and an ordinary loss under the same provision in the same year, and thus would result—as in the case at bar—in extending a double benefit, which was obviously not the intent of Congress.

We submit that the soundness of this view is confirmed not only by the general role of partnerships under the federal tax laws, but by the legislative history of Section 117 (j), and by the relevant principles established in Supreme Court and appellate decisions—in particular, *Neuberger* v. *Commissioner,* 311 U. S. 83, which ruled that a taxpayer might offset his individual losses from non-capital security transactions against his share of partnership gains of the same nature.

For these reasons we submit that the decision of the Tax Court should be reversed.

ARGUMENT

Computation of a Taxpayer's Net Gain or Loss Under Section 117 (j) of the Internal Revenue Code of 1939 Must Include the Taxpayer's Share of Partnership Gains or Losses Under Section 117 (j), and the Tax Court Erred in Ruling to the Contrary

A. *Preliminary*

Upon undisputed facts this appeal presents a single question of law: Must the computation of a taxpayer's net gain or loss under Section 117 (j) of the Internal

Revenue Code of 1939 include the taxpayer's share of partnership gains or losses under Section 117 (j)? The Tax Court has answered this question in the negative. The Commissioner contends that the question must be answered in the affirmative, and hence that the decision below should be reversed.

Section 117 (j) (Appendix, *infra*) deals with the tax consequences of the sale, exchange or involuntary conversion of certain non-capital assets "used in the trade or business". Section 117 (j)(2) (Appendix, *infra*) provides in substance that if gains exceed losses in the sale, exchange or conversion of such assets, "such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months"; but that if such gains do not exceed such losses, "such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets." In brief, if there is a net gain, it is taxable as a long-term capital gain; but if there is a net loss, it is deductible in full as an ordinary loss.

In the case at bar, as detailed in the statement, *supra,* it is undisputed that taxpayers sustained individual losses under Section 117 (j) in 1948 and 1949; and that in the same years the taxpayer-husband was a member of a partnership which realized gains under Section 117 (j). In taxpayers' joint returns for 1948 and 1949 taxpayers' individual Section 117 (j) losses were deducted in full in computing net income; but the taxpayer-husband's shares of the partnership Section 117 (j) gains were taken into account as long-term capital gains. The Tax Court ruled that this treatment was proper; that Section 117 (j) applies to a partnership as an entity distinct from the individual partners;

and hence that gains realized by a partnership under Section 117 (j) are fixed once and for all as long-term capital gains, in which the partners share distributively. In this view it is immaterial that the partners may have individual losses under Section 117 (j). Such losses are deductible in full as ordinary losses, without reference to or offset by the partner's distributive share of the partnership's Section 117 (j) gains.

We submit that this construction of Section 117 (j) is in error; that Congress intended and has clearly required the computation of a single net gain or loss under Section 117 (j) for a given taxpayer in a given tax year; and that to permit insulation of partnership gain or loss in the manner sanctioned by the Tax Court is to defeat this intention and requirement. We submit that a partnership's net gain or loss under Section 117 (j) must retain its identity as such in the hands of the partners, and that each partner's distributive share of such gain or loss must be offset against his individual gain or loss of the same nature. As demonstrated below, this result follows necessarily ~~form~~ from the terms of the relevant statutes, from legislative history, and from the principles established by controlling Supreme Court and appellate decisions.

B. *Taxpayers must offset the husband's distributive share of partnership gains under Section 117 (j) in 1948 and 1949 against their individual losses of the same nature in the same years*

The question of statutory construction presented by this appeal is one which requires consideration of the limited role played by partnerships in federal income taxation.

Unlike a corporation, a partnership is not a taxpaying entity for federal income tax purposes. Section 181 of the Internal Revenue Code of 1939 (Appendix, *infra*) constitutes a reenactment of the provision long-established in the revenue laws that "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." And while Section 187 (Appendix, *infra*) requires that partnerships file yearly informational returns, ~~and~~ we submit that no taxes are assessed on the basis of these returns. It is only as partnership gain or loss enters distributively into the computation of the net incomes of the individual partners that such gains or loss has tax consequences.

It is evident, however, that before partnership gains and losses can enter distributively into the individual incomes of the partners there must be some consistent method to which all the partners must adhere in determining the total gains and losses which are to be distributed. This method is provided by Sections 182 and 183 (Appendix, *infra*). Section 183 provides that "The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual," except that capital items shall be segregated before such computation, and that partnerships shall not be allowed either the so-called "charitable contribution" deduction nor the standard deduction allowed to individuals. Section 182 provides that the individual partner, in computing his net income, shall include, whether or not distribution is made to him: (a) his distributive share of the partnership's short-term capital gains and losses as part of his individual short-term capital gains and losses; (b) his distributive share of the partnership's long-term capital gains and losses

as part of his individual long-term capital gains and losses; and (c) his distributive share of the partnership's ordinary net income or loss, computed as provided in Section 183.

It is apparent from the above provisions that a partnership is an accounting unit, although not a taxpaying unit, under the federal tax laws. In order to make the computations required by Section 182 a partnership must have its own accounting method and period, as distinct from the accounting methods and periods of its individual members. Thus partnership gains and losses may be reflected in the individual returns of the partners in years other than those in which they would have been reported if they had been individual gains or losses of the partners. The accounting status thus accorded to partnerships is obviously desirable in view of the diversity which may obtain between the partners individually as to accounting methods and periods.

But it should be noted that the only necessary consequence of the partnership's accounting status is that it determines *when* the partners must report partnership gains and losses. It does not follow that particular items of gain realized and loss sustained by the partnership lose their identity in the computations of net partnership gains and losses which precede reflection of distributive shares in the partners' individual returns. The underlying concept, embodied in Section 181, is that the partners are the taxpayers. It is the partners collectively who realize directly the partnership gains and sustain directly the partnership losses. *Craik* v. *United States*, 31 F. Supp. 132 (C. Cls.).

To what extent, then, do particular items of partnership gain and loss retain their original identity in the hands of the individual partners?

Like preceding Revenue Acts, the 1939 Code provides some answers—but only partial answers—to this question. As noted above, Section 183 provides that partnership capital items shall be segregated; and Section 182 provides that each partner shall take into account separately his distributive shares of the partnership's short-term capital gains and losses, long-term capital gains and losses, and ordinary net income or loss. In general, then, partnership items retain their identity as capital or ordinary in the hands of the partners. And in particular, Sections 183 through 189 provide that certain non-capital partnership items—none relevant here —retain their identity in the hands of the partners, largely in the form of credits against income.

The instant appeal involves Section 117 (j) gains or losses. Each Section 117 (j) gain or loss originates in the disposition of a non-capital asset; but such gains and losses are neither capital nor ordinary in nature until reduced to a net figure which, if a gain, is capital but, if a loss, is ordinary. The partnership provisions of the 1939 Code, summarized above, do not deal expressly with these ambivalent items, any more than they deal expressly with a host of other particular items of gain and loss. It could well be argued that this lack of particularity in the statute is of no significance in view of the underlying principle that it is the partners who collectively realize partnership gains and sustain partnership losses. * As it happens, however, it is unnecessary

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* In the new Internal Revenue Code of 1954 Congress has provided expressly in Section 702 (a) (3) that each partner shall take into account separately his distributive share of partnership gains and losses from sales or exchanges of property described in Section 1231 of the 1954 Code, which is the successor to Section 117 (j) of the 1939 Code. Furthermore, Section 702 (b) states that

to argue about this point; for the Supreme Court has spoken in a decision which disposes of the matter and which, we believe, requires reversal in the case at bar. That is the decision in *Neuberger* v. *Commissioner,* 311 U.S. 83.

The *Neuberger* case involved Section 23 (r) of the Revenue Act of 1932, c. 209, 47 Stat. 169, which provided that "Losses from sales or exchanges of stocks and bonds * * * which are not capital assets * * * shall be allowed [as deductions from gross income] only to the extent of the gains from such sales or exchanges * * *." The taxpayer there had sustained individual loss of the nature described by Section 23 (r) in the same year that a partnership of which he was a member had realized gain of the same nature. The Supreme Court held that the taxpayer was entitled to deduct his individual loss to the extent of his distributive share of the partnership gain. In other words, the Supreme Court ruled that a partnership's Section 23 (r) gains retained their identity as such in the hands of the individual partners.

It is to be noted that the partnership provisions of the Revenue Act of 1932 involved in the *Neuberger* case were, in all essential respects, very similar to the partnership provisions of the 1939 Code. Section 181 of the 1932 Act provided that "Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity"; and Section 189 provided for the filing of partnership informational returns. Sec-

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the character of any item of income, gain, loss, deduction or credit included in a partner's distributive share shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership. Legislative history reveals that Congress considered these provisions to be merely declaratory of current law and practice. H. Rep. No. 1337, 83d Cong., 2d Sess., p. 221; S. Rep. No. 1622, 83d Cong., 2d Sess., p. 89.

tion 183 provided that "The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual"; and Section 186 provided for the segregation of partnership capital gain and loss, the separate reporting thereof by the partnership, and the separate taxation thereof to the individual partners. Section 185 also provided for the segregation of the partnership's earned income. Sections 184 and 188 provided that certain non-capital items be carried over distributively from the partnership to the partners as credits against net income.

In short, the partnership provisions of the 1932 Act contain all of the salient features pointed out above in the partnership provisions of the 1939 Code. Under both the 1932 Act and the 1939 Code, partnerships are not taxpaying entities but are accounting units; partnership capital gains and losses are segregated, reported separately and taxed separately; and certain non-capital items retain their identity in the hands of the partners to be applied distributively as credits against net income.

The Commissioner argued before the Supreme Court in *Neuberger*—as the taxpayers may argue here—that because the partnership provisions of the tax laws specified certain instances in which partnership items retained their identity in the hands of the partners, like survival of any other items was precluded. The Supreme Court rejected this argument, saying (p. 88):

> Nor is the deduction claimed here precluded because Congress, in §§ 184-188, has particularized instances where partnership income retains its identity in the individual partner's return. The maxim *expressio unius est exclusio alterius* is an aid to construction, not a rule of law. It can never override clear and contrary evidences of Congres-

sional intent. *United States* v. *Barnes,* 222 U.S. 513.

In searching for general evidence of Congressional intent in the partnership provisions of the 1932 Act the Supreme Court said (pp. 86-87):

> Respondent points out, however, that under §§ 181-189 of the Revenue Act of 1932 * * * partnership income is computed on an entity basis, that items of partnership gross income do not appear on a partner's return, that only partnership net income is reflected in the individual partner's income and is reported only in the form of a distributable or distributed share. He contends that since partnership income is computed in the same way as an individual's the deduction afforded by §§ 23 (r)(1) to the partnership is a distinct privilege not to be confused or combined with that afforded the individual.

Nevertheless, the Supreme Court emphasized that (p 88):

> In requiring a partnership informational return although only individual partners pay any tax, Congress recognized the partnership both as a business unit and as an association of individuals. This weakens rather than strengthens respondent's argument that the privileges are distinct or that the unit characteristics of the partnership must be emphasized. Compare *Jennings* v. *Commissioner,* 110 F. 2d 945; *Craik* v. *United States,* 31 F. Supp. 132; *United States* v. *Coulby,* 251 F. 982 (affirmed, 258 F. 27).

Thus the Court found that the Congressional intent expressed in the partnership provisions was to treat

partnerships as aggregations of individuals, save for accounting purposes. This accords with the view that partnership gains and losses are attributable directly to the individual partners in all respects save that of when such gains and losses shall be reported by the partners.

However, the Supreme Court did not rest there. Searching for more specific Congressional intent, it scrutinized the legislative history of Section 23 (r) and noted that the intention behind its enactment was to limit a taxpayer's losses from non-capital security transactions to the extent of his gains from such transactions, thus stemming the large (and theretofore unlimited) deductions which had followed in the wake of the 1929 crash. The Court recognized that the focus of this intention was upon the individual taxpayer. It was the individual taxpayer whose deductions were to be limited. On the other hand it was the individual taxpayer who was entitled as of right to Section 23 (r) deductions to the extent of his Section 23 (r) gains. And the Court held that the taxpayer was entitled to deduct his individual Section 23 (r) losses to the extent of his distributive share of partnership Section 23 (r) gains, saying (pp. 85-86)—

> Nowhere does there appear any intention to deny to a taxpayer who chooses to execute part of his security transactions in partnership with another the right to deductions which plainly would be available to him if he had executed all of them singly.

It should be noted that the Supreme Court reached this result despite the fact that the gains and losses involved resulted from the disposition of non-capital assets; and that the partnership provisions of the Revenue Act of 1932 in no way excepted such items of gain

or loss from the requirement that, after segregation of capital items, the ordinary net income or loss of the partnership be computed as in the case of an individual. It should also be noted that the tax consequences of a Section 23 (r) gain depended entirely upon whether there were deductible losses of the same nature; while Section 23 (r) losses were not available as deductions unless there were comparable gains. In short, only after gathering together the gains and losses of the taxpayer and reaching a net figure could the tax consequences be determined.

The relevance of these considerations, and of the reasoning of the Supreme Court in *Neuberger,* must be apparent. The gains and losses covered by Section 117 (j) result from the disposition of non-capital assets; and the partnership provisions of the 1939 Code in no way except such gains and losses from the requirement that, after segregation of capital items, the ordinary net income or loss of the partnership be computed as in the case of an individual. But the important fact is that Section 117 (j) contemplates a comingling of *all* a taxpayer's gains or losses from the disposition of certain assets. It is only after gathering together the gains and losses of the taxpayer and reaching a net figure that the tax consequences can be determined.

Was it the intention of Congress that partnership gains or losses under Section 117 (j) should be insulated from gains or losses of the individual partners under the same section? Legislative history requires a negative answer to that question. Section 117 (j) was added to the 1939 Code by the Revenue Act of 1942; and it is stated in the House Report on that Act (H. Rep. No. 2333, 77th Cong., 2d Sess., p. 53 (1942-2 Cum. Bull. 372, 415)):

> Under existing law, the gain or loss from the sale or exchange of depreciable property is not treated

> as a capital gain or capital loss, but as an ordinary gain or an ordinary loss. This rule was originally inserted as a relief provision to enable corporations to have the full benefit of a loss from the sale of machinery, instead of being limited by the capital loss provisions, which would permit it only a certain percentage of the loss. It was felt at that time that the taxpayer should not be denied the full loss because it sold the property at a loss instead of abandoning the property. While this rule provided relief in case a loss was realized, it appears that many taxpayers are able to dispose of their depreciable property at a gain over its depreciated cost. To treat such a gain as an ordinary gain will result in an undue hardship to the taxpayer.

Thus Section 117 (j) was enacted as a relief measure for the taxpayer. It is the taxpayer who is to receive capital gain treatment of his net gains under Section 117 (j) in order to preclude undue hardship. It is the taxpayer who is allowed to deduct in full his net losses under Section 117 (j) in order that he may not be penalized for selling the property instead of simply abandoning it. The focus of this section and of the intention of Congress being thus upon the taxpayer, it follows, under the reasoning of the *Neuberger* decision, that a taxpayer's distributive share of partnership gains or losses under Section 117 (j) must be included in computing his net gain or loss of that nature. Congress surely did not intend that a taxpayer should benefit twice from Section 117 (j) in the same year, receiving capital gain treatment as to his share of partnership gains, and at the same time benefiting from the deduction in full of his individual losses.

Just how unrealistic and inequitable such a double benefit could be is illustrated by the hypothetical situa-

tion in which a taxpayer sustains individual losses under Section 117 (j) of $50,000, while receiving in the same year $100,000 as his distributive share of partnership gains of the same nature. If the tapayer's share of the partnership gains were not set off against his individual losses, but fixed once and for all as long-term capital gains, the taxpayer would take 50 percent of his share into account, or $50,000, in computing net income. At the same time, he would deduct his individual losses of $50,000 in full. Thus, the individual and partnership items would cancel out; and if the taxpayer had no other income, he would pay not one cent in taxes, although he had netted $50,000 in actual income. On the other hand, if both the $100,000 gain and the $50,000 loss had been partnership items, or if both had been individual items, they would have been set off against each other in reaching a single net figure under Section 117 (j) and a tax would have been payable on the net gain of $50,000. The only possible conclusion, we submit, is that no such inconsistent application of Section 117 (j) was either contemplated or intended by Congress.

We submit that the soundness of this conclusion is self-evident. Nor does the *Neuberger* decision stand alone as authority for this result, if authority be needed. In *Mosbacher* v. *United States,* 311 U.S. 619, the Court was presented with the converse of the *Neuberger* question, i.e., whether a partner's distributive share of partnership Section 23 (r) losses could be offset against individual gains of the same nature. The Second Circuit had held that this could not be done. The Supreme Court reversed and remanded on authority of the *Neuberger* decision.

Similarly, in *Jennings* v. *Commissioner*, 110 F. 2d 945 (C.A. 5th), certiorari denied, 311 U.S. 704 the question was whether a partner could offset his individual

wagering losses against his distributive share of partnership wagering gains under Section 23 (g) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, which provided that: "Losses from wagering transactions shall be allowed only to the extent of the gains from such transactions." The court answered the question in the affirmative, saying (p. 946)—

> A partnership is recognized as an entity separate from the partners in bankruptcy proceedings, but not in income taxation. *United States* v. *Coulby*, 6 Cir., 258 F. 27. For many years the Revenue Acts have provided that "individuals carrying on business in partnership shall be liable for income tax only in their individual capacity." * * * The partnership return is for information, and to secure uniformity and save repetition in the individual returns. It ascertains each partner's gain and apportions it to him to be taxed, whether distributed or not. It does not transform his share in the gain.

Similarly, in *Craik* v. *United States*, 31 F. Supp. 132 (C. Cls.), it was held that a nonresident alien who was a member of a partnership operating in the United States, but with income from sources without the United States, was not taxable upon his share of partnership income so far as allocable to such sources under Section 213 (c) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, which provided that "In the case of nonresident alien individuals, gross income includes only the gross income from sources within the United States." There too, as in the other decisions discussed above, items of partnership gain and loss were held to retain their identity in the hands of the partners

even though no specific warrant for such retention was to be found in the federal tax laws.

The basic principle underlying these cases was expressed by the court in *Craik* v. *United States, supra,* when it said (p. 135):

> We are convinced that Congress intended that partnership income should be treated as though it had been received by the partners individually.

In its opinion herein (R. 23-25) the Tax Court relies upon its decision in *Ammann* v. *Commissioner,* 22 T.C. 1106, which is now before the Fifth Circuit for review. No other authority is cited. In *Ammann,* the Tax Court cited two of its own decisions; but they are not in point. They merely illustrate that, since a partnership has its own accounting method and period, elections on behalf of a partnership involving such method and period are binding on the partners. Thus in *Scherf* v. *Commissioner,* 20 T.C. 346, where a partnership sold its assets under circumstances permitting treatment of the sale either as a completed transaction or as an installment sale, it was held that the election of the partnership to report the sale on the former basis was binding on the partners individually. Similarly, in *Bentex Oil Corp.* v. *Commissioner,* 20 T.C. 565, it was held that a partnership is entitled either to deduct as necessary expenses or to capitalize intangible drilling costs, and that this election is binding on the partners individually. Plainly, these decisions are concerned only with the independent accounting status of the partnership, which determines when the partners shall report their distributive shares of partnership items. They do not in any way support the

proposition that partnership items lose their identity in the computation of net partnership gain or loss, in the face of a clear Congressional requirement that all of a taxpayer's gains and losses of a certain nature shall be taken together to reach a net figure. Such a requirement surely means that a partner's distributive share of partnership gains or losses of the described sort must be taken into account.

The Commissioner adopted the position reflected in this brief after the *Neuberger* decision, and has adhered consistently to this view as a matter of administrative practice since that time. See G.C.M. 22491, 1941-1 Cum. Bull. 374; G.C.M. 22461, 1941-1 Cum. Bull. 295; I.T. 3981, 1949-2 Cum. Bull. 78.

We submit that both authority and common sense confirm the soundness of this position; and hence that computation of a taxpayer's net gain or loss under Section 117 (j) of the 1939 Code must include the taxpayer's share of such partnership gains or losses.

It follows that the Tax Court erred in its decision below, since it failed to rule that the husband-taxpayer's distributive share of partnership gains under Section 117 (j) in 1948 and 1949 should be offset against taxpayers' individual losses of the same nature in the same years.

CONCLUSION

For the reasons set forth above, we submit that the Tax Court's decision is in error and should be reversed.

Respectfully submitted,

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Internal Revenue Code of 1939:

SEC. 117. CAPITAL GAINS AND LOSSES.

* * * * *

(b) [As amended by Sec. 150(c) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net capital gain, net capital loss, and net income:

100 per centum if the capital asset has been held for not more than 6 months;

50 per centum if the capital asset has been held for more than 6 months.

* * * * *

(j) [As added by Sec. 151(b) of the Revenue Act of 1942, *supra*, and as amended by Sec. 127(b) of the Revenue Act of 1943, c. 63, 58 Stat. 21] *Gains and Losses From Involuntary Conversion and From the Sale or Exchange of Certain Property Used in the Trade or Business.*—

(1) *Definition of property used in the trade or business.*—For the purposes of this subsection, the term "property used in the trade or business" means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(l), held for more than 6 months, and real property used in the trade or business, held for more than

6 months, which is not (A) property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. Such term also includes timber with respect to which subsection (k) (1) or (2) is applicable.

(2) *General Rule.*—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than 6 months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph:

(A) In determining under this paragraph whether gains exceed losses, the gains and losses described therein shall be included only if and to the extent taken into account in computing net income, except that subsections (b) and (d) shall not apply.

(B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion.

(26 U.S.C. 1952 ed., Sec. 117.)

Sec. 181. Partnership Not Taxable.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1952 ed., Sec. 181.)

Sec. 182. Tax of Partners.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) [As amended by Sec. 150(g)(1)(A) of the Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) [As amended by Sec. 150(g)(1)(B) of the Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U.S.C. 1952 ed., Sec. 182.)

Sec. 183. Computation of Partnership Income.

(a) [As amended by Sec. 9(c)(1) of the Individual Income Tax Act of 1944, c. 210, 58 Stat. 231] *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b), (c), and (d).

(b) [As amended by Section 150(g)(2)(A) of the Revenue Act of 1942, *supra*] *Segregation of Items.*—

(1) *Capital gains and losses.*—There shall be segregated the gains and losses from sales or exchanges of capital assets.

(2) *Ordinary net income or loss.*—After excluding all items of gain and loss from sales or exchanges of capital assets, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

* * * * *

(26 U.S.C. 1952 ed., Sec. 183.)

Sec. 187. Partnership Returns.

Every partnership shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe, and shall include in the return the names and addresses of the individuals who would be entitled to share in the net income if distributed and the amount of the distributive share of each individual. The return shall be sworn to by any one of the partners.

(26 U.S.C. 1952 ed., Sec. 187.)

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